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JGN Access Arrangement – Cross period pass through

Dear Mr Reeves

In advance of Jemena Gas Networks (NSW) Ltd (**JGN**) submitting draft revisions to its Access Arrangement (**AA**) on 30 June 2014, staff from the Australian Energy Regulator (**AER**) and JGN have engaged in a number of constructive meetings. JGN acknowledges and thanks the AER for the level of engagement undertaken to date, as well as the engagement committed to going forward.

Purpose

The purpose of this letter is to seek some further clarity on the AER's position in relation to cost pass through events, in the circumstance where the cost impacts of such events are potentially experienced over two successive AA periods (**Cross Period Pass Through**).

Issue

Recognition of Cross Period Pass Through in an AA would potentially allow the financial impact of an approved cost pass through event that occurs late in one AA period to be addressed in the reference tariffs that apply in the next AA period. This would arise in circumstances where the financial impact of the relevant event cannot practically be included in reference tariffs in the AA period in which the event occurs. For example, where the cost impact remains unknown for some time, or if the event occurs in the last weeks of the AA period, thus making a tariff variation problematic.

This is consistent with the year-on-year pass through events (subject to an administrative threshold) and "administrative" pass-through adjustments (not subject to a threshold) that the AER currently approves for JGN under its approved AA, save that the years involved span the transition from one AA period to the next.

This issue was discussed at a meeting involving AER and JGN staff on 12 September 2013. JGN clarified that its primary areas of concern involved circumstances where expenditure is incurred (or savings made) as a consequence of a cost pass through event that occurs:

- after JGN's 2014 tariff variation but before the end of the current AA period (30 June 2015); or

- in one AA period, but where the cost impact is unknown until the following AA period; or
- in one AA period, where there are cost impacts both in that AA period as well as the next AA period.

Practical example

Of particular relevance are cost pass through events under JGN's current AA where costs are incurred in a particular regulatory year, but those costs are then subject to administrative pass-through adjustments (a true up between actual costs and AER approved allowances) after the end of the relevant regulatory year. This includes the unaccounted for gas (**UAG**) adjustment event and licence fee event.

The timings of these events for JGN's current AA period are shown in Table 1. Without recognition of Cross Period Pass Through, there would be:

- no true-up for regulatory year 2014-15 UAG variances from allowance; and
- no true-up for regulatory years 2013-14 and 2014-15 licence fee variances from allowance.¹

This is despite an administrative pass-through adjustment for the two events occurring for every other year within the AA period.

Table 1. Timing and direction of JGN administrative pass-through adjustments - 2010-15 AA

Year of variation	2011	2012	2013	2014	Currently no true-up for
Licence Fee Event	No adjustment	2010-11 year refund to customers	2011-12 year refund to customers	2012-13 year value - to be confirmed	2013-14 and 2014-15
UAG adjustment event	2010-11 year refund to customers	2011-12 year refund to customers	2012-13 year pass through to customers	2013-14 year value – to be confirmed	2014-15

JGN currently anticipates that the cost impacts of the above UAG adjustment event could potentially be in the vicinity of [c-i-c] for 2013-14 and within a range of [c-i-c] to [c-i-c] for 2014-15.

Position under the National Gas Rules (NGR)

The NGR clearly contemplate that reference tariffs may be varied “as a result of a cost pass through for a defined event” (see rule 97(1)(c)). Beyond this, the NGR do

¹ This is due to Independent Pricing and Regulatory Tribunal issuing its invoices for a regulatory year in June. For example the 2012-13 licence fees are invoiced in Jun 2013. As tariff variations need to be submitted by April of each year, the next tariff variation they can be included in is therefore the 2014 variation.

² Note that JGN has not yet tendered for UAG gas prices for 2014-15 and the range provided recognises the uncertainty associated with NSW gas prices at present. This includes a lower range of 4% increase consistent with increases prior to 2013-14 and an upper range of 14.6% increase which is consistent with the 2013-14 increase. Gas receipts used in the calculations are also estimates.

³ These values are considered confidential; publishing them may harm JGN's ability to procure UAG gas at competitive rates.

not seek to further regulate pass through events, whether such events occur wholly in one AA period, or not. In particular, the NGR do not specifically preclude Cross Period Pass Through.

In light of this, JGN considers that the AER is, under the current NGR, able to approve as part of the reference tariff variation mechanism to apply in its 2015-20 AA, a mechanism that would provide for the cost recovery for Cross Period Pass Through (including in each of the scenarios of concern set out previous in this letter). Moreover, JGN considers that Cross Period Pass Throughs are equally as rule compliant and consistent with the National Gas Objective as the annual within period pass throughs and administrative pass through adjustments, which have been approved under our current AA.

Recent regulatory treatment

The AER approved a fixed principle in APA GasNet's current AA that specifically permits Cross Period Pass Through.⁴

In addition, in August 2012, the Australian Energy Market Commission (**AEMC**) made a new electricity rule on 'Cost pass through arrangements for network service providers'.⁵ In making its final decision, the AEMC considered that the National Electricity Rules (**NER**) inadvertently prohibited a Network Service Provider (**NSP**) from seeking pass-throughs that crossed AA periods. The AEMC considered that allowing cross period pass-through would remove a known anomaly from the NER and enable consistent treatment of pass-through events, whenever they occur. The AEMC considered that this was consistent with the revenue and pricing principles such that a NSP is provided a reasonable opportunity to recover at least the efficient costs it incurs in providing network services.

JGN notes that whilst the basic principle is the same, the wording of the NER provisions under scrutiny in that case is quite different from the cost pass through provisions in the NGR, and as such it does not follow that the NGR need to be amended in the same way.

The AER has also commented on cost pass through in its submissions to the AEMC's Economic Regulation of Network Service Providers rule change, noting that 'The pass through mechanism is designed to allow the businesses to recover the costs associated with a significant event that was outside of its control'.⁶ This statement is consistent with allowing Cross Period Pass Through.

JGN's proposed approach

Consistent with APA GasNet's fixed principle and the principle specifically recognised in the NER, JGN is considering giving effect to Cross Period Pass Through in its 2015-20 AA. This would include mechanisms that allow pass through from the:

- 2010-15 AA into the 2015-20 AA;
- 2015-20 AA into the 2020-25 AA.

⁴ APA GasNet, 2013-17 Access Arrangement, p. 24.

⁵ AEMC, 'Cost pass-through arrangements for network service providers', Final rule determination, 2 August 2012.

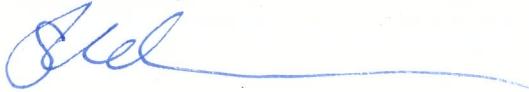
⁶ AER submission on AEMC draft rule determination – Economic regulation of network service providers, 5 October 2012, p. 14.

These mechanisms would be subject to AER approval when considering the JGN AA.

JGN has committed to a timetable for its customer and stakeholder consultation program in relation to its 2015-20 AA. To engage customers on its pass through strategy JGN is seeking clarity on the AER's current thinking with regard to the principle of Cross Period Pass Through. JGN currently intends to further engage with stakeholders on its UAG strategy in December 2013 and into the new year. To this extent, JGN would value and appreciate any guidance the AER is willing to provide in regard to allowing Cross Period Pass Through in JGN's forthcoming AA.

If you would like to discuss any aspect of this letter, please contact me on 03 8544 9446.

Yours sincerely



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Jemena Limited